

**IN THE
SUPREME COURT OF MISSOURI**

No. SC92446

**BASF CORPORATION, INC,
Appellant,**

v.

**DIRECTOR OF REVENUE,
Respondent.**

**On Petition for Review from the
Missouri Administrative Hearing Commission**

REPLY BRIEF OF APPELLANT

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ARGUMENT

Appellant BASF Corporation, Inc. (“BASF”) replies as follows to the Director of Revenue’s Brief. References to the Director’s Brief are as (“Resp. at ____.”) References to the Appellant’s Brief Appendix are as (“Appellant’s Appendix at A-____.”) References to the Reply Brief Appendix are as (“Reply Brief Appendix at A-____.”)

I. The Hannibal Plant processes recovered materials.

The question framed by BASF’s appeal is whether BASF processes recovered materials, as defined by Missouri law, at the Hannibal Plant. If the Hannibal Plant processes recovered materials, then the Plant qualifies for the material recovery processing plant exemption set out at RSMo. § 144.030.4.

According to the Director, recovered materials must consist of solid waste and a “solid waste stream” must consist only of solid waste without a drop of liquid. (Resp. at 8-13.) Because the Hannibal Plant recovers and processes liquids, the Director argues, BASF does not process “recovered materials” and cannot qualify for the material recovery processing plant exemption. The Director’s argument contravenes the plain language of RSMo § 144.030.4, the Director’s own Regulation and published Letter Rulings, and Missouri’s established policy that encourages industrial firms to recover and process chemical byproducts rather than dispose them into landfills. The undisputed facts establish that the Hannibal Plant processes recovered materials and, consequently, qualifies as a material recovery processing plant under the statute in effect during the time at issue.

Recovered materials are defined by RSMo § 260.200.28 as “materials which have been diverted or removed from the solid waste stream.” The statute does not provide that the “materials diverted or removed from the solid waste stream” must themselves consist of solid waste. The General Assembly easily could have provided that recovered materials consist of solid waste and only solid waste – all potatoes and no soup – but it did no such thing. Indeed, by providing that recovered materials include all “materials diverted or removed from the solid waste stream,” the General Assembly established that recovered materials include materials more than just solid waste. The words “materials diverted from” are different from the words “solid waste stream,” and they necessarily mean that recovered materials include more than solid waste.

Any construction of Section 260.200.28 must give effect to all the words in the statute. *Gurley v. Missouri Bd. of Private Investigator Examiners*, 361 S.W.3d 406, 413 (Mo. banc 2012) (“When interpreting a statute, this Court must give meaning to every word or phrase of the legislative enactment.” (citation omitted)). Applying this rule of law and common sense, the General Assembly’s definition of recovered materials as “materials diverted from” the solid waste stream cannot be read to mean that recovered materials consist only of solid waste.

While the Director now claims that recovered materials may only consist of solid waste, the Director’s own Regulation, 12 C.S.R. 10-111.060.4(B), says just the opposite. The Regulation expressly defines recovered materials to include “liquid waste” for purposes of the material recovery processing plant exemptions. The Director’s only reported letter ruling on this subject is to the same effect and provides that a plant that

processes “liquid waste materials, including solvents, paints, organic chemicals, dry cleaning fluids and oils” qualifies as a material recovery processing plant. Letter Ruling 8886, Missouri Department of Revenue, May 17, 1996. (Appellant’s Appendix at A-65-66.) There is no principled distinction between the liquid waste materials that the Director agreed qualified as recovered materials in 12 C.S.R.10-111.060.4(B) and Letter Ruling 8886 and the liquid waste that BASF recovers and processes at the Hannibal Plant. The liquid waste that BASF processes at the Hannibal Plant therefore qualifies as a recovered material as a matter of Missouri law.

The Director largely ignores the definition of recovered materials contemplated by 12 C.S.R.10-111.060.4(B) and Letter Ruling 8886 and contends that the term “solid waste stream” implies not a stream that contains solids and liquids, but rather a “constantly renewed supply” of some unspecified consistency. (Resp. at 9.) Whether this definition is plausible or not (BASF submits that it is not), the definition itself does not restrict the term recovered materials to solid waste and nothing else.

Furthermore, the Director overlooks the meaning of the words “diverted or removed” in the phrase “diverted or removed from the solid waste stream.” Waste “removed” from a “constantly renewed supply” of solid waste might imply that the material removed is in solid form. However, waste “diverted” from a “constantly renewed supply” of solid waste permits no such implication. The material “diverted” from the waste stream is by definition not part of the “constantly renewed supply” of solid waste; it never enters the waste stream. *See e.g. Kessler Containers, Ltd. v. Director of Revenue*, No. 02-1549 RV (February 1, 2005) (Holding that “diverted,” as

used in Section 260.200.28, means "to turn from one course or use to another: DEFLECT[.]," citing MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 339 (10th ed. 1993)) (Reply Brief Appendix at A-7). Nothing in the Director's suggested definition speaks to whether this diverted material is a liquid or solid. What the undisputed facts do establish is that the Hannibal Plant diverts liquid waste away from a "constantly renewed supply" of solid waste – the Missouri landfills into which the Plant's waste materials would be deposited but for their recovery and processing into a form that can be reused.

In the same vein, the Director argues that the Hannibal Plant "does not convert recovered materials into a new product, or a different form, which is used in producing a new product." (Resp. at 10-11), citing RSMo. § 144.030.2.4.) The Director further maintains that there is no evidence that the solvents used at the Hannibal Plant "are transformed into something else or that they change form to produce herbicides and pesticides." (Resp. at 10-11.) These arguments ignore the undisputed record evidence and the AHC's express findings of fact.

As the parties' Stipulation provides and the AHC found, Processes A, C, and D continually recover solvents and other necessary chemicals and process them into a useable form. For example, the AHC found that the Hannibal Plant removes "spent" sulfuric acid from the Process streams. The process streams at this point contain spent sulfuric acid (acid diluted to either 39% concentration or 75% concentration), along with another acid and water. To process the spent sulfuric acid, the Hannibal Plant combusts the spent sulfuric acid, the other acid, and the water solution in a gas-fired furnace, which

transforms the sulfuric acid into two gaseous forms. The gaseous sulfuric acid is next hydrolyzed (molecularly reacted with water) to create a 98% sulfuric acid liquid – at which point the processed acid can be used in a new production cycle. (A.-10-12.)¹ These facts clearly establish that the Hannibal Plant converts spent recovered materials into a new form that can be reused to produce additional finished molecules in future production cycles.

The Director argues further that the Hannibal Plant is not a “recycling facility [sic]” because the Plant “does not even recycle waste.” (Resp. at 12-13.) In support of this declaration, the Director relies solely on RSMo § 260.200.34. However, Section 260.200.34 merely defines the term “solid waste.” It neither states nor implies that the Hannibal Plant must recover and process solid waste to qualify for the material recovery processing plant exemption. For the reasons stated above and in BASF’s initial brief, the Hannibal Plant need not recover solid waste to qualify as a material recovery processing plant.

¹ The AHC found that the Hannibal Plant employs similar recovery and processing processes for solvents and chemicals other than sulfuric acid. *See e.g.* (Appellant’s Appendix at A-17-20, describing processing of solvents C-4, C-3, and C-1 through distillation and “washing” techniques that remove impurities and return the solvents to a useable form); (Appellant’s Appendix at A-21-23 describing processing of solvents D-2 and D-1 through distillation and “caustic wash” techniques that remove impurities.)

Relying again on the definition of “solid waste” (which does not determine whether the Hannibal Plant processes recovered materials), the Director maintains that the solvents that the Hannibal Plant recovers and processes do not qualify as recovered materials because they are not “discarded.” (Resp. at 12-13.) The Director asserts that byproducts from BASF’s own manufacturing Processes cannot qualify as recovered materials because these materials by definition have been recovered before they were “discarded.” This argument does not accord with the text and plain meaning of the material recovery processing plant exemption. Indeed, the AHC has rejected this argument and found that recovered materials consist of materials that would be “discarded” in the ordinary course of business unless they are diverted or removed from a waste stream. *See Kessler Containers, Ltd. v. Director of Revenue*, No. 02-1549 RV (February 1, 2005) (plastic pellets recovered from taxpayer’s manufacturing cycle and processed by the taxpayer held to be recovered materials) (Reply Brief Appendix at A-7). As the AHC found in *Kessler Containers*, a contrary ruling would defeat the purpose of the material recovery processing plant exemption. *Id.* (Reply Brief Appendix at A-7).

Finally, while doubts about whether a tax exemption applies are normally construed against the taxpayer, exemptions must be given a reasonable interpretation that is consistent with the General Assembly’s intent in enacting the exemption. *State of Missouri ex rel. Ozark Lead Company v. Director of Revenue*, 610 S.W.2d 954, 957 (Mo. 1981). The unreasonably constricted definition of recovered materials that the Director urges this Court to apply is at odds with the General Assembly’s demonstrated intent to

encourage recovery of industrial manufacturing byproducts. This Court should overrule the AHC's legal ruling that recovered materials cannot include liquids, and find as a matter of law that the Hannibal Plant qualifies as a material recovery processing plant.

II. The AHC's legal ruling that recovered materials cannot include liquids was not reasonably foreseeable and reflects a new policy that should be applied, if at all, only on a prospective basis.

As a matter of Missouri law, a decision is "unexpected" and may only be applied on a prospective basis if "a reasonable person would not have expected the decision or order based on prior law, previous policy or regulation of the department of revenue." RSMo §143.903.2 RSMo 32.053 is to the same effect and provides: "Any final decision of the department of revenue which is a result in a change in policy or interpretation by the department effecting a particular class of person subject to such decision shall only be applied prospectively."

Recognizing these rules of law and basic fairness, the Director argues that the AHC's decision that recovered materials must consist of "solid waste," and must not contain liquids, was somehow reasonable and foreseeable. (Resp. at 13-15.) But the Director cites no legal authority for this proposition, and none exists. Missouri law and the Director's own Regulation and Letter Rulings are squarely to the contrary. As stated above, nothing in the text of RSMo §144.030.4 supports the notion that recovered materials may only consist of solid waste. For that reason, the Director's own Regulation, 12 C.S.R. 10-111.060.4(B), and Letter Rulings recognize that recovered

materials may consist of liquids. The Director's established policy, as manifested by its Regulation and its Letter Rulings, accords with the basic purpose of the material recovery processing plant exemption – encouraging industrial manufacturers to recycle and reuse the byproducts of their operations, rather than dispose of them into landfills.

BASF had every right to rely on the Director's Regulation and Letter Rulings as it recovered and processed the byproducts of Processes A, C, and D at the Hannibal Plant. The Director's Regulations and Rulings are meaningful only to the extent Missouri taxpayers are able to govern their affairs by them; that is why Missouri law permits agencies such as the Director of Revenue to change its policies only on a prospective basis. *Greenbriar Hills Country Club v. Director of Revenue*, 47 S.W.3d 346, 357-58 (Mo. Banc 2001) (“Agencies cannot promulgate, or repeal, a rule by an adjudicated order.”) Accordingly, if this Court affirms the AHC's decision, that affirmance should be on a prospective base only.

III. The record evidence establishes that BASF's solvents are required for the operation of material recovery machinery and equipment and only for the operation of that machinery and equipment.

The Director contends that BASF's purchases of solvents are not exempt because BASF did not show that the solvents are required solely for the operation of exempt machinery and equipment at the Hannibal Plant. (Resp. at 16-17.) The undisputed evidence refutes this position.

The machinery and equipment at issue are chemical reactors. As the parties stipulated and the AHC found, the chemical reactors are “specifically engineered” to serve one purpose at the Hannibal Plant – “to contain and enhance chemical reactions ... [and] create an environment where the chemical reaction[s] can occur with the highest possible efficiency.” (Appellant’s Appendix at A-7.) Without the chemicals used at the Hannibal Plant, the chemical reactors would not and could not perform their only intended purpose. The AHC likewise found that the reactions in the chemical reactors “would not occur, or would occur in a negligible amount, regardless of the temperature, pressure, or agitation by the reactor” without the chemicals. (Appellant’s Appendix at A-7.) And the parties stipulated that the solvents BASF purchased are “required solely to achieve the desired chemical reactions within” the chemical reactors. (L.F. 00171, 00175, 00177, 00182, emphasis added.) BASF thus clearly demonstrated that the chemicals it uses at the Hannibal Plant are required solely for the operation of exempt equipment. The Director does not and cannot identify any grounds for disregarding these basic questions of stipulated fact – how, why, and where BASF uses the chemicals at the Hannibal. The AHC’s contrary ruling (Appellant’s Appendix at A-37-38) should be reversed.

The Director argues that the AHC’s decision should nonetheless be affirmed because the chemical reactors might be able to supply heat, pressure, and agitation for

some unknown purpose without the solvents. (Resp. at 17.) There is no evidence in the record to support this argument; the Director's argument fails for this reason alone.²

Moreover, even if the reactors were able to apply heat, pressure, and agitation without solvents, that would not make the solvents subject to use tax. RSMo § 144.030.4 does not ask whether exempt machinery could in theory be used for some purpose other than material recovery and processing. Rather, the statute asks whether the supplies purchased by the taxpayer are "required solely for the operation" of this exempt equipment. Again, the parties stipulated that the solvents BASF purchases are "required solely" to achieve the desired chemical reactions within the chemical reactors, and that the reactors could not perform their intended purpose without the solvents. There is no basis in the record for speculating that the solvents were used, or could have been used, for any purpose other than driving Processes A, C, and D. The Court need not go any further to find that BASF's solvents are required solely for operating exempt machinery and equipment at the Hannibal Plant.

² The Director's argument also contradicts its long-established policy. For example, in Letter Ruling 8886, the Director found that personal protective/safety gear worn by workers at a material recovery processing plant was exempt. (Appellant's Appendix at A-65-66.) The safety gear had no effect on the operation of the machinery and equipment in the plant, but the gear was found exempt because the workers were required to wear it when operating the equipment. *Id.*

IV. BASF proved that coal and gas used at the Hannibal Plant are required solely for the operation of exempt equipment.

The Director next argues that BASF did not adequately prove that the coal and gas used at the Hannibal Plant were used solely to operate exempt equipment. The Director's position is that BASF did not show which pieces of equipment consuming coal and gas qualify as material recovery machinery and equipment. (Resp. at 18.) The record evidence cannot support this position.

The Hannibal Plant burns coal in boilers to create steam. The boilers are exempt machinery and equipment because they supply the steam that heats and pressurizes the chemical reactors and other equipment used to carry out Processes A, C, and D. (Appellant's Appendix at A-25-26.) These Processes – which would not occur absent the heat and pressure provided by the coal-fired boilers – yield the spent solvents that the Hannibal Plant recovers, processes, and introduces into additional production cycles. (Appellant's Appendix at A-25-26.) Similarly, BASF burns gas at the Hannibal Plant to recover spent sulfuric acid, the primary solvent used at the Hannibal Plant, into a form that can be reused in later production cycles. (Appellant's Appendix at A-24.) The Director does not identify any basis for an inference that the Hannibal Plant uses coal to operate non-exempt machinery or equipment. BASF thus satisfies its burden to show that the coal burned at the Hannibal Plant is required solely to operate exempt equipment at the Hannibal Plant.

As explained in BASF's initial brief, the parties did not dispute whether the Hannibal Plant burns coal and gas to operate exempt machinery in the proceedings before

the AHC. (Initial Brief at 29-30.) The parties disputed only whether coal and gas qualify as “supplies” for purposes of RSMo § 144.030.4, and the AHC ruled in BASF’s favor on this sole contested issue of fact. The Director’s Brief does not contest BASF’s request for a factual remand (BASF Initial Brief at 29-30) on the questions of whether and to what extent the Hannibal Plant burns coal and gas to operate exempt machinery. Accordingly, if this Court finds any ambiguity in the record about whether BASF burns coal and gas to operate exempt machinery, the Court should remand the case to the AHC for a final determination on this narrow issue.

V. BASF’s purchases of electricity are exempt for all tax years because the raw materials used in processing contain 42% recovered materials.

The Director asserts that the Hannibal Plant does not process recovered materials and, on that basis, argues that the plant does not qualify for the electricity exemption provided by RSMo 144.030.12. (Resp. at 19.) For the reasons stated above, the Hannibal Plant processes recovered materials and, therefore, qualifies for the electricity exemption.³

³ The Director argues that the BASF must qualify as a material recovery processing plant to qualify for the electricity exemption provided by RSMo § 144.030.12, but that argument is incorrect. (Resp. at 19.) While qualifying as a material recovery processing plant would be a sufficient qualification for the electricity exemption, it is not a necessary qualification. RSMo § 144.030.12 requires only a showing that the raw materials processed at the Hannibal Plant consist of 25% recovered materials.

The Director also argues that the electricity exemption should not be allowed because the Hannibal Plant does not meet “the 25% test.” (Resp. at 19-20.) The Director does not argue that the Plant failed to pass this test for each relevant tax year and, in fact, concedes that BASF showed that the raw materials recovered and processed at the Hannibal Plant consist of at least 25 percent recovered materials for tax years 2004 through 2006. However, citing BASF’s declarations of recovered sulfuric acid, the Director asserts that BASF did not show that the raw materials processed at the Hannibal Plant consist of at least 25% recovered materials with respect to tax years 2001 through 2003. (Resp. at 19-20.) This argument contradicts the AHC’s dispositive finding of fact on this point. As the AHC found:

On an annual basis, as measured by weight, all of the items recovered from the internal recovery processes performed at the Hannibal Plant and all of the recovered materials that are purchased from third-party vendors account for approximately 42% of the total inputs used in the production processes of all finished molecules of the Hannibal Plant.

(Appellant’s Appendix at A-23, emphasis added.)

This finding plainly establishes the 25% recovered materials threshold required by RSMo § 144.030.12. The Court should reject out of hand the Director’s argument that BASF failed to satisfy the 25% test.

CONCLUSION

For the foregoing reasons, as well as the reasons set forth in BASF's initial brief, BASF respectfully requests that this Court vacate the AHC's denial of (i) BASF's challenge to the Director of Revenue's assessment of use tax relating to BASF's purchase of chemicals during 2000 and 2001 and (ii) BASF's claim for a refund of use tax paid to the Director of Revenue for purchases of natural gas, coal, and electricity from 1999 through 2005. BASF further requests that the Court remand the case to the AHC for the sole purpose of calculating the refund due to BASF based on BASF's erroneous payment of use tax for electricity, coal, and natural gas from 1999 through 2005.

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CERTIFICATE OF COMPLIANCE WITH MISSOURI SUPREME
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The undersigned certifies that the foregoing brief complies with the limitations contained in Missouri Supreme Court Rule 84.06(b) in that according to the word count function of Microsoft Word by which it was prepared, contains 3,435 words, exclusive of the cover, the Certificate of Service, this Certificate of Compliance, and the signature block.

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CERTIFICATE OF SERVICE

I hereby certify that the above and foregoing was filed electronically this 15th day of October, 2012, causing a true and correct copy to be transmitted to:

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